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**Article**

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## GLOBAL VALUE CHAINS AND ECA CONTENT POLICIES

DAVID DRYSDALE<sup>1</sup>

Global value chains (GVCs) have become a dominant feature of world trade. As world markets have become increasingly integrated, businesses are spreading their chains of production across the globe. Instead of producing goods in locations near major suppliers or consumers, multinational firms are benefitting from the sharp falls in transport and communication costs over the past two decades to establish GVCs across several countries.

To begin providing the evidence needed to respond to the policy questions raised by the growing importance of GVCs for trade and investment, the OECD and WTO embarked on an initiative to measure trade in value added (TiVA) terms to provide an accurate view of its underlying economic importance. By identifying where value is being added, it is possible to estimate where income and jobs are created. In addition, it provides a new perspective on bilateral trade imbalances. The TiVA database was launched by the OECD and WTO in January 2013.

Today, success in international markets depends as much on the capacity to import world class inputs as on the capacity to export. One indication of such production fragmentation is the rising share of intermediate inputs in world trade. These inputs to the production process now represent 56 percent of trade in goods and 73 percent of trade in services.

In this context, why aren't all official export credit agencies (ECAs) liberalising their content policies to adapt to this new paradigm? As some of you know, the United States and Germany are on the conservative side when it comes to content policy. All official ECAs seek to maximise their own national benefit – usually linking support for exports

to domestic employment. Some ECAs, like the United States, Ex-Im Bank, still limit support to pure national content – made in and shipped from United States; while others, such as Canada focus on national interest, a flexible concept that provides more leeway to support Canadian firms rather than just exports. Germany, while on the conservative end of the spectrum, has recently liberalised its content policies to a limited extent. I would say that US exporters would love to have the flexibilities that Germany has, but German exporters will probably tell you that they would like to resemble Canada or Japan.

What are the reasons for these different approaches in determining the scope of their ECA support? I see three main reasons for these differences: economic size; economic philosophy; and economic culture.

### Economic size

The most obvious reason for rigid versus flexible content policies is economic size. The United States' GDP stood at about 16 trillion US dollars in 2012, while Canada's GDP amounted to about 1.8 trillion US dollars. Some US exporters, especially multilateral companies like GE, have long sought greater flexibility in Ex-Im Bank content policies. GE is a global competitor, with manufacturing facilities all over the world. Those opposing liberalisation, such as trade unions, point to the concern that loosening Ex-Im's content policies will encourage the outsourcing of production to foreign countries, only hurting US employment. Given the size of the US economy, US exporters can source from California to Florida, from New York to Texas – all large economies in their own respect (approximately 5.9 trillion US dollars in 2012 – that is 36 percent of the total US GDP).

By contrast, Canadian exporters have a smaller economy to source from. It is much harder for them in a world of global value chains to expect that the majority of exports from Canada can be 100-percent made in Canada – and the same goes for all of



<sup>1</sup> OECD.

the smaller members of the EU. Even Germany, the largest EU economy at 3.4 trillion US dollars, is still small compared to the United States. Thus it makes sense that most EU ECAs allow some content from other EU members to count as domestic content in their systems. As the whole of the EU is about the same size, economically, as the United States, just think if you had a single export credit agency in the EU. You could then source from all over the EU and may not have to worry about content to the same extent.

### **Economic philosophy**

Some OECD countries provide export credit support to national companies based on them being 'national champions'. This is a form of national interest, as national champions are flag-bearers for their respective countries. To an extent, at least philosophically, it is a form of state capitalism, with the state standing behind its largest companies. These countries are more willing to support non-domestic content as part of exports by these champions. Bombardier would be a classic example of such a company. It makes airplanes with a tremendous amount of US content, yet EDC supports Bombardier's aircraft exports as if they were 100-percent Canadian.

By contrast, the US economy is more market capitalism focused, and the term national champion is a dirty word. A constant refrain in US politics is that the government should not pick winners and losers. Moreover, it is very difficult in an economy the size of the United States to have a single national champion in a particular sector where there may be several national firms competing in that sector. That is one reason why the government does not want to pick winners and losers.

### **Economic culture**

Historically, Japanese ECAs have had one of the most liberal content policies of any ECA. I ascribe this to the concept of cultural economy – Japanese companies seek to maximise Japanese success. This is best described by the term Japan Inc. While I have no hard evidence of this concept, it has been my perception over the years that Japanese companies take Japanese economic benefit into account in their economic decision-making. By contrast, in the

United States and more broadly in western countries, economic philosophy is more about the bottom line – economic decisions are based on profit maximisation.

Thus, in this context, the Japanese government can provide Japanese firms with greater flexibility in sourcing because there is a Japan Inc. mentality. For the same reason, the US government has a more rigid content policy, as US companies are more likely to outsource their supply chain if it stands to improve the bottom line.

I would also like to mention another element that is typical of many Asian countries like Japan, Korea, or China. They are all major importers of natural resources and provide export credit support to a lot of these types of projects. Therefore, they are very often looking at these projects as the offer-taker, rather than as the supplier, and that is why they are much more likely to be willing to provide more flexibility on content.

The OECD does not have any specific guidelines regarding content requirements. Each government establishes its own guidelines in this area, and they vary among ECAs. Nor is there a normative policy that all should apply. Each government decides the parameters of content policies based on its economic and political priorities. Of course, a competitive advantage can actually be gained from winning a deal via the application of a more liberal content policy, but perhaps at the expense of broader domestic economic concerns.

At this point I would like to briefly discuss the organisation of ECAs and their government oversight. In the United States, US Ex-Im has a charter that is reauthorised approximately every four years. It has a sunset clause stating that if Congress does not reauthorise it, they close. This means that Congress has to make a formal decision to continue Ex-Im, and can make changes to the Ex-Im charter at that time.

In the last reauthorisation, the export community felt that the export initiative on doubling exports in five years would open the door to pro-export attitudes, which means that Congress should change the content policies, allow more foreign content, and perhaps allow some special flexibilities in calculation of the content. For instance, in the United States, if you make a tractor, but the nuts and bolts are im-

ported from Mexico, you have to subtract those from the value of the US content. There is no incorporation rule.

The opposition to this push was surprisingly strong – not only from Labour, but also from both the Democrats and the Republicans. In the US political system you could say – stereotypically – that the Democrats are pro-labour and the Republicans are pro-business. But the Republicans were just as strongly opposed to any liberalisation – as tax dollars should only be used to support US jobs.